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THE ROLE OF DEVELOPMENT FINANCE INSTITUTIONS (DFIs) IN THE FINANCING OF SMALL-SCALE INDUSTRIES (SSIs)

BY
O. E. ESSIEN*

INTRODUCTION

The post-independence Nigerian government adopted the import-substitution large-scale industrialisation strategy to accelerate the country's industrial development. The dearth of indigenous entrepreneurship constrained government to assume the role of the entrepreneur and the urge to offset the economic neglect of the colonial government resulted in ambitious industrialisation programmes. When the Nigerian Industrial Development Bank Limited (NIDB) was established in 1964 for the purpose of speeding up the industrialisation process, its mandate was to promote industrial projects which were large enough to make appreciable contribution to the national economy.

However, the collapse of the oil boom in the early 1980's exposed the inherent weaknesses of this strategy. The inability to sustain the importation of inputs resulted in large idle capacities. thereby crippling many large industrial enterprises. Industrial output as well as industry's contribution to the gross domestic product (GDP) declined in the face of the strong national aspiration for the restructuring of the economy and reduction of the dependence on petroleum. Small and medium scale industries have since become the focus of national industrial policy.

In order to put our discussion into proper perspective, we need to know what we mean by SSIs in the Nigerian context. The following are the current official definitions of industrial enterprises adopted by the 13th Meeting of the National Council on Industry (NCI-I3) in Makurdi, Benue State, in July, 2001:

i) **Micro/Cottage Industry:** An industry with total capital employed of not **more than** NI *.50* million, including **working capital but** excluding cost of land, and/or a labour size of not more than 10 workers;

ii) Small-Scale Industry: An industry with total capital employed of over N1.50 million but not more than N50.00 million, including working capital but excluding cost of land, and/or a labour size of 11 -100 workers;

iii) **Medium-Scale Industry:** An industry with a total capital employed of over N50.00 million but not more than N200.00 million, including working capital but excluding cost of land, and/or a labour size of 101-300 workers;

iv) **Large-Scale Industry**: An industry with a total capital employed of over N200.00 million, including working capital but excluding cost of land, and/or a labour size of over 300 workers.

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It may also be informative to see how SSIs were defined in some selected countries where they are given much policy focus.

Country	Investment Ceiling	Employment Ceiling
India	6.0 million Rupees(US$ 170,000)	No Restriction
Indonesia	150 million Rupiah (US$85,000)	NoRestriction
Japan	100 million Yen (US$800,000)	300
Korea (South)	500 million Won (US$730,000)	300
Malaysia	250,000 MS (US$100,000)	No Restriction
Philippines	I million Peso (US$45,000)	99
U.K.	No Restriction	199
U.S.A.	No Restriction	99

Source: Ram K. Kepa, Modern Small Industry in India, Sage Publications (1988)

The definitions above indicate that the use of investment cost as a yardstick is very popular in the developing countries, while developed countries focus on employment *size.* In China, small-scale industry was defined by sector using output as follows:

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Iron and Steel: Output less than 10,000 tonne / year
Textiles: Capacity less than 25,000 spindles/year
Watches: Capacity less than 400,000 pieces/year
Cement: Capacity less than 200,000 tonne/year

Despite these variations, the definitions provide the respective countries with the necessary framework for the administration of policy measures designed for SSIs.

II. THE ECONOMIC POTENTIAL OF SSIs

The critical importance of adequate credit delivery to SSIs derives from the fact that their development is what is required to enable the country's industrial sector meet the contemporary challenges of globalisation. economic restructuring, and poverty eradication. The economic significance of SSIs has been recognised worldwide.

In 1953, The United States of America enacted THE SMALL BUSINESS ACT. which reads, in part: *"The essence of the American Economic* System *of private enterprises is competition. It is the declared policy of the Congress that the Government should aid counsel, assist and protect, in so far as possible, the interest of small business concerns in order to preserve them from competitive enterprise."1*

The President of the United States is also required by law, to give a ***State of Small Business*** address similar only to the Stale of the Union address annually. In 1954, the Netherlands issued its own ***White Paper*** on the development of small-scale industries. In 1959, the Federal Republic of Germany followed with its ***Policy Framework on SMEs,*** while in 1963, Japan enacted ***The Fundamental Laws on Small and Medium Enterprises.*** South Korea, India and many other South-East Asian countries followed. It is arguable that SSIs have contributed immensely to the success story of the foregoing economies.

However, SSIs are particularly more suited to the circumstances of developing countries. Their greater reflection of a country's relative factor endowments promotes employment and enhances international economic competitiveness. This is crucial in an increasingly globalised world . Another major advantage of SSIs in a capital-scarce economy like Nigeria is their relatively shorter gestation periods which enable them to yield quicker returns on investment for further productive investment and faster growth. SSIs also have a greater potential to facilitate the development of indigenous entrepreneurship and economic independence.

SSIs are critical in the effort to reduce industrial import-dependence. They can be used to meet the input needs of large enterprises. This has been a major factor in the success of the industrialised countries. For instance, through a sub-contracting arrangement, large enterprises in Japan, basically assemble the intermediate products and components produced by numerous smaller enterprises. Similarly, in Brazil, there are well over 300 SSIs producing components for the Brazilian Volkswagen industry alone. Some countries, such as Indonesia and India, have legally reserved the production of certain goods and industrial inputs for their SSIs in order to maximize their developmental potential.

Relatedly, the enhancement of international competitiveness by SSIs stimulates the expansion of industrial exports. Furthermore, by facilitating industrial dispersal and balanced development, SSIs alleviate rural-urban migration and its anti-social consequences.

Finally. SSIs are useful in mobilising small savings for productive investment and enhancement of the industrial capital formation. In a country with a low level of savings like Nigeria, SSIs are ideal for the mobilisation of resources for economic development.

III. THE FUNDING ROLE OF DEVELOPMENT FINANCE INSTITUTIONS (DFIs)

The paucity of financial resources has been generally acknowledged as a major constraint on investment and economic growth in Nigeria. Given the fact that the level of domestic savings is too low to fund and sustain the level of investment consistent with national economic growth targets, the funding role of DFIs will continue to he indispensable in the foreseeable future.

Compared with trading. SSIs (like other industrial enterprises) are long-gestating and risky. They are even considered riskier than larger industrial enterprises by the banking system. Consequently, when the Central Bank of Nigeria (CBN) statutory credit guidelines were in force, these profit-motivated financial institutions preferred to pay the penalty rather than undertake investments in SSIs. In essence, SSIs are not attractive to commercial and merchant banks. Moreover, the bulk of the funding needed by SSIs consists of long-term credit which commercial and merchant banks are not in a position to provide. Indeed, some of them ventured into term lending and created a mismatch between their

deposit liabilities and the tenor of their loans. This was one of the factors that contributed to the distress in the banking system. Generally, they operate at the short-term end of the financial market. However, it is a heartening development that some progress is being made towards getting the banks to invest 10.0 per cent of their pre-tax profit in the equity of SSIs.

DFIs are the major operators at the long-term end of the financial market. Long-gestating projects need long-term loans in order to be viable. It is for this reason that the newly industrialised countries use DFIs to channel funds for industrial development. Some of the DFIs have established subsidiary companies for the sole purpose of funding SSIs. A typical example is the Industrial Development Bank of India (IDBI) which since April, 1990, has had a fully-owned subsidiary for the financing of SSIs, The Small Industries Development Bank of India (SIBDI).

DFIs in Nigeria should be similarly used by government to channel funds to SSIs. The use of commercial and merchant banks as participating banks in NERFUND and the defunct SME II scheme is instructive in this respect. Many of the banks failed to present a single project. They are really not to blame because they are not tailored to provide long-term financing.

Even though the mandate of NIDB was originally to finance medium and large industrial enterprises, it has in recent years shifted its focus to small and medium industries (SMIs) in line with the current national industrial policy emphasis. The Bank was the most active participating bank in NERFUND and SME II. The number of projects financed by NIDB through the SME II and NERFUND schemes stands at 83 with a total disbursement of N628 million. Prior to the two schemes, NIDB had disbursed about N2.O billion to SMIs over the years from the resources mobilized by it directly from the World Bank and European Investment Bank.

In its effort to promote the national objective of industrial dispersal, poverty eradication and rural development, NIDB has invested considerable resources to make its services in the promotion of SMIs available to industrialists in different parts of the country. The six Area Administrations of the Bank, whose operations span the whole federation, have played a commendable role in the discharge of their promotional and funding assignments to SMIs.

NIDB has expended a substantial amount of resources on investment opportunity and sector studies for the promotion of strategic SMIs. With the assistance of the European Economic Community (EEC) and the World Bank, NIDB undertook investment opportunity studies leading to concrete investments in SMIs in three sub-sectors: agro-allied, chemicals and engineering. The Bank has plans to expand its activities in this regard, given the availability of more resources. Of particular concern to the Bank now is the urgent need for the rehabilitation of SMIs that are ailing as a result of the country's difficult macroeconomic environment. One major advantage of funding by DFIs is that it is invariably accompanied by technical assistance right from the project conception and appraisal stages through implementation to commercial operation.

The traditional role of DFIs as specialist purveyors of long-term development finance will remain indispensable to Nigeria for sometime to come. This assertion is predicated on the following:

i. the country's inadequate development of a deep and liquid long-term debt market as yet, which would provide project finance to corporates;

ii. DFIs captive project appraisal capabilities which other banks are yet to emulate;

iii. DFIs have been more useful to most developing countries as avenues of inflow of foreign capital. Even in countries that have failed in attracting foreign direct and portfolio investment because of low credit rating, development banks (including NIDB) have managed to procure and utilise funds from multilateral and regional development agencies productively.

IV. MAJOR CONSTRAINTS OF THE SSIs SUB-SECTOR

SSIs have their share of the problems which generally plague the country's industrial sector. These include inadequate equity base, inadequate working capital, technical constraints, infrastructural deficiencies and the tariff policy.

Equity Base

For any industrial enterprise to thrive, it must have an adequate equity base, that is. an equity base which is in the right proportion to bank credit. Lenders use the debt/equity (gearing) ratio criterion to ensure that they are not over-exposed. In other words, a limited amount of equity may make it difficult for an enterprise to raise enough loan for the establishment of the desired scale of operation. Moreover, the debt-service burden of high gearing is detrimental to viability. Sponsors of all sizes of industrial enterprises should, if need be, seek collaboration with other

partners when their own resources are inadequate.

Working Capital

A major problem plaguing the operation of SSIs is their inability to raise working funds from the banking system because of the perceived risk. Indeed, adequate provision of working capital is all that the resuscitation of a good number of ailing SSIs would require. Government should ensure that all future SSIs as well as medium scale industries (MSIs) funding schemes have a working capital window. DFIs should be financially equipped to extend working capital credit to SMIs in addition to long-term loans.

Technical Constraints

Like large enterprises, SSIs need modern managerial skills to succeed: resources which are known to be in short supply in the country. Therefore, government and the organised private sector must jointly ensure that approriate and functional technical assistance schemes are put in place for SSIs. In this regard, the National Association of Small Scale Industrialists (NASSI) as well as the Nigerian Association of Small and Medium Enterprises (NASME) must collaborate with the Industrial Development Centres (IDCs) of the Federal Government. The IDCs must also be better equipped for this purpose.

Infrastructural Deficiencies

The current situation whereby each industrial enterprise is compelled to provide its own electricity, water, and in some cases, access roads to offset deficiencies in public infrastructural facilities is detrimental to viability. The effect on capital and operational costs also adversely affects the competitiveness of the national economy. The relative burden of such extra costs is much heavier on SSIs. The ongoing effort of government to improve infrastructural facilities should be intensified.

Tariff Policy

Nigeria is a signatory to the World Trade Organisation (WTO) Agreement on trade liberalisation and is, therefore, expected to promote the cause of free trade. However, national interest should be paramount in the pursuit of trade liberalisation. Not even the industrial countries are throwing their borders open indiscriminately to imports. They still protect their industries in one form or the other. The current situation whereby Nigeria's market is virtually taken over by dumped goods (new and second-hand) should be urgently redressed. Otherwise, industrial development will continue to be an unrealized dream even in the distant future.

V. CONCLUSION

The future of Nigeria's industrialisation process is largely dependent on the fortunes of the SSIs sub-sector considering its inherent benefits to a developing economy. It is the sub-sector that holds the promise of meeting Nigeria's industrialisation challenges in this century. Consequently, all the parties involved in the promotion of the sub-sector (government, private sector, and the banking system) must jointly ensure that the sub-sector is given all the support it needs to play its role effectively.

Note

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